

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200735023**

Release Date: 8/31/2007

Index Number: 2652.01-02, 61.00-00,
1001.00-00, 2642.00-00

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B09

PLR-158582-06

Date:

April 26, 2007

In Re:

Decedent =
Spouse =
State Statute =
Date 1 =
A =

Dear :

This is in response to your letter dated December 18, 2006, submitted by your authorized representative, and subsequent correspondence, requesting rulings under §§ 61, 1001, and 2652(a)(3) of the Internal Revenue Code, § 26.2654-1(b)(1) of the Generation-Skipping Transfer Tax Regulations, and §§ 301.9100-1 and 301.9100-3 of the Procedure and Administration Regulations.

The facts submitted and the representations made are summarized as follows. Decedent died on Date 1, survived by his spouse (Spouse) and issue.

Article Third, Section B of Decedent's Will provides that an amount equal in value to the largest amount that can pass free of Federal estate tax by reason of the unified credit and the state death tax credit, together with any credit available for gift taxes payable with respect to gifts made by the Decedent after December 31, 1976 is to be held in trust.

Article Third, Section C provides that the remainder of Decedent's gross estate is to be held in trust (Marital Trust). Marital Trust has GST potential.

Spouse, as the executrix of Decedent's estate, retained a qualified tax professional to prepare the Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, for Decedent's estate. The Form 706 was timely filed, and on the Schedule M, the estate made the election under § 2056(b)(7) (the qualified

terminable interest property (QTIP) election) for the Marital Trust. On part 4 of the form, the estate indicated that the Marital Trust was to be divided into a GST exempt and a GST nonexempt trust. On Schedule R of the form, the estate signified that Decedent's remaining GST exemption of \$A was to be allocated to the GST exempt trust. The estate, however, failed to divide the Marital Trust into a GST exempt and a GST nonexempt trust. In addition, the tax professional who prepared the Form 706 failed to make or advise Spouse to make the election under § 2652(a)(3) (the reverse QTIP election) for the GST exempt trust.

Sometime later, Spouse retained a law firm to provide personal estate tax planning. The law firm discovered that the Marital Trust had not been divided into a GST exempt and nonexempt trust, and that the reverse QTIP election had not been made for the GST exempt trust.

Spouse, as trustee of the Marital Trust and executrix of Decedent's Will, intends to divide the Marital Trust into a GST exempt trust and a GST nonexempt trust. State Statute, in effect on Date 1, provides that a trustee may, unless expressly prohibited by the terms of the instrument establishing the trust, divide a trust into two or more separate trusts without a judicial proceeding if the trustee reasonably determines that the division of the trust could result in a significant decrease in current or future federal income, gift, estate, GST taxes, or any other tax imposed on trust property. If the trustee divides the trust, the terms of the separate trusts must be identical to the terms of the original trust, but differing tax elections may be made for the separate trusts.

The Marital Trust's assets will be divided between the GST exempt trust and the GST nonexempt trust on a pro-rata basis. The provisions of the GST exempt trust and the GST nonexempt trust will be the same as the provisions of the Marital Trust. It has been represented that \$A of Decedent's GST exemption is available to allocate to the GST exempt trust.

Spouse, as trustee of the Marital Trust and executrix of Decedent's estate, has requested the following rulings.

1. An extension of time under §§ 301.9100-1 and 301.9100-3 to sever the Marital Trust into a GST exempt trust and a GST nonexempt trust under § 26.2654-1(b)(1), and to make a reverse QTIP election under §2652(a)(3) for the GST exempt trust.
2. A ruling that the proposed division of the Marital Trust into the GST exempt trust and the GST nonexempt trust is a partition that does not result in recognition of gain or loss by the Marital Trust or any resulting trust under §§ 61 and 1001.

Law and Analysis – Ruling 1:

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2056(a) provides that, for purposes of the tax imposed by § 2001, the value of the taxable estate is to be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property that passes or has passed from the decedent to the surviving spouse.

Section 2056(b)(1) provides the general rule that no deduction shall be allowed for an interest passing to the surviving spouse if, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, the interest will terminate or fail and (A) an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than the surviving spouse (or the estate of such spouse); and (B) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse.

Section 2056(b)(7)(A) provides that, in the case of QTIP, the entire property shall be treated as passing to the surviving spouse for purposes of §2056(a), and no part of the property shall be treated as passing to any person other than the surviving spouse for purposes of §2056(b)(1).

Section 2056(b)(7)(B)(i) defines "qualified terminable interest property" (QTIP) as property: (1) which passes from the decedent; (2) in which the surviving spouse has a qualifying income interest for life; and (3) to which an election under §2056(b)(7)(B)(v) applies.

Section 2056(b)(7)(B)(v) provides that an election under §2056(b)(7) with respect to any property shall be made by the executor on the return of tax imposed by §2001. The election, once made, is irrevocable.

Under §2044(a), any property in which the decedent possessed a qualifying income interest for life and for which a deduction was allowed under §2056(b)(7) is includable in the decedent's gross estate.

Section 2601 imposes a tax on every generation-skipping transfer.

Section 2602 provides that the amount of tax is the taxable amount multiplied by the applicable rate. Section 2641(a) defines "applicable rate" as the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer.

Section 2642(a) provides the method for determining the inclusion ratio.

Section 2631(a) provides that, for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of \$1,000,000 (adjusted for inflation under §2631(c)) that may be allocated by such individual (or by his or her executor) to any property with respect to which such individual is the transferor. Section 2631(b) provides that once an allocation of GST exemption is made, it is irrevocable.

Under §2632(a), the allocation of the GST exemption may be made at any time on or before the date prescribed for filing the individual's estate tax return (including extensions).

Section 2632(e)(1) (formerly §2632(c) – See P.L. 107-16) provides that, in general, any portion of an individual's GST exemption which has not been allocated within the time prescribed by §2632(a) shall be deemed to be allocated as follows – (A) first, to property which is the subject of a direct skip occurring at the individual's death, and (B) second, to trusts with respect to which the individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after the individual's death.

Section 2652(a)(3) provides that in the case of any trust with respect to which a deduction is allowed to the decedent's estate under §2056(b)(7), the estate of the decedent may elect to treat all of the property in the trust, for purposes of the GST tax, as if the QTIP election had not been made. This election is referred to as the reverse QTIP election. The consequence of a reverse QTIP election is that the decedent remains, for GST tax purposes, the transferor of the QTIP trust for which the election is made. As a result, the decedent's GST exemption may be allocated to the QTIP trust.

Section 26.2652-2(b) provides that the reverse QTIP election is to be made on the return on which the QTIP election is made.

Section 26.2654-1(b)(1)(ii) provides that the severance of a trust that is included in the transferor's gross estate (or created under the transferor's will) into two or more trusts is recognized for purposes of chapter 13 if the governing instrument does not require or otherwise direct severance but the trust is severed pursuant to discretionary authority granted either under the governing instrument or under local law; and

(A) The terms of the new trusts provide in the aggregate for the same succession of interests and beneficiaries as are provided in the original trust;

(B) The severance occurs (or a reformation proceeding, if required, is commenced) prior to the date prescribed for filing the federal estate tax return (including extensions actually granted) for the estate of the transferor; and

(C) Either –

(1) The new trusts are severed on a fractional basis. If severed on a fractional basis, the separate trusts need not be funded with a pro rata portion of each

asset held by the undivided trust. The trusts may be funded on a non pro rata basis provided funding is based on either the fair market value of the assets on the date of funding or in a manner that fairly reflects the net appreciation or depreciation in the value of the assets measured from the valuation date to the date of funding; or

(2) If the severance is required (by the terms of the governing instrument) to be made on the basis of a pecuniary amount, the pecuniary payment is satisfied in a manner that would meet the requirements of §26.2654-1(a)(1)(ii) if it were paid to an individual.

Under §301.9100-1(c), the Commissioner may grant a reasonable extension of time under the rules set forth in §§301.9100-2 and 301.9100-3 to make a regulatory election, or a statutory election (but no more than 6 months except in the case of a taxpayer who is abroad), under all subtitles of the Code except subtitles E, G, H, and I.

Sections 301.9100-1 through 301.9100-3 provide the standards the Commissioner will use to determine whether to grant an extension of time to make a regulatory election.

Section 301.9100-2 provides for automatic extensions of time for making certain elections.

Section 301.9100-3(a) provides that, in general, requests for extensions of time for regulatory elections that do not meet the requirements of §301.9100-2 must be made under the rules of §301.9100-3. Requests for relief subject to §301.9100-3 will be granted when the taxpayer provides the evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the Government.

Section 301.9100-3(b)(1)(v) provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make, the election.

In this case, as a result of the QTIP election made on the Form 706, the Marital Trust's assets are includible in Spouse's gross estate pursuant to §2044. Spouse, accordingly, is the transferor of the Marital Trust's assets for GST tax purposes. Therefore, Decedent's GST exemption cannot be allocated to the Marital Trust's assets. However, if the Marital Trust is severed into two trusts, a GST exempt trust and a GST nonexempt trust, and a reverse QTIP election under §2652(a)(3) is made with respect to the GST exempt trust, Decedent will be treated as the transferor of the GST exempt trust's assets, and Decedent's GST exemption may be allocated to the GST exempt trust. It has been represented that \$A of Decedent's GST exemption is available to allocate to the GST exempt trust.

Based on the facts submitted and the representations made, we conclude that the requirements of §301.9100-3 have been satisfied. Accordingly, the estate is granted sixty (60) days from the date of this letter to sever the Marital Trust into a GST exempt trust and a GST nonexempt trust as described herein and to file a supplemental Form 706 on which the reverse QTIP election is to be made for the GST exempt trust and Decedent's GST exemption of \$A is to be allocated to the GST exempt trust. The supplemental Form 706 should be filed with the Internal Revenue Service Center, Cincinnati, Ohio 45999. A copy of this letter should be attached to the return.

Ruling 2:

Section 61(a)(3) provides that gross income includes gains derived from dealings in property.

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

Section 1001(b) states that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. Under § 1001(c), except as otherwise provided in subtitle A, the entire amount of gain or loss, determined under § 1001, on the sale or exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides that the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent, is treated as income or loss sustained.

A partition of jointly owned property is not a sale or other disposition of property where the co-owners of the joint property sever their joint interests but do not acquire a new or additional interest as a result of the transaction. Thus, neither gain nor loss is realized on a partition. See Rev. Rul. 56- 437, 1956-2 C.B. 507.

Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991), concerns the issue of whether a sale or exchange that has taken place results in the realization of gain or loss under § 1001. In Cottage Savings, a financial institution exchanged its interests in one group of residential mortgage loans for another lender's interests in a different group of residential mortgage loans. The two groups of mortgages were considered "substantially identical" by the agency that regulated the financial institution.

The Supreme Court of the United States in Cottage Savings, concluded that § 1.1001-1 reasonably interprets § 1001(a) and stated that an exchange of property gives rise to a

realization event under § 1001(a) if the properties exchanged are "materially different." In defining what constitutes a "material difference" for purposes of § 1001(a), the Court stated that properties are "different" in the sense that is "material" to the Internal Revenue Code so long as their respective possessors enjoy legal entitlements that are different in kind or extent. Cottage Savings, 499 U.S. at 564-65. The Court held that mortgage loans made to different obligors and secured by different homes did embody distinct legal entitlements, and that the taxpayer realized losses when it exchanged interests in the loans. Cottage Savings, 499 U.S. at 566.

In the present case, the Marital Trust was divided on a pro-rata basis. Except for the division and a few minor administrative changes, the operating provisions of the Marital Trust remained unchanged. Accordingly, the Marital Trust was divided but the beneficiaries' interests in the property did not change in kind or extent and no new interests were created. It is consistent with the Supreme Court's opinion in Cottage Savings to find that the interests of the beneficiaries of the GST exempt trust and the GST nonexempt trust will not differ materially from their interests in the Marital Trust.

Therefore, based upon the facts submitted and the representations made, we conclude that the division of the Marital Trust into the GST exempt trust and the GST nonexempt trust does not result in recognition of gain or loss for federal income tax purposes to the Marital Trust or the resulting trusts under §§61 and 1001.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied as to the value of the assets included in the gross estates of Decedent or Spouse for Federal transfer tax purposes.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

William P. O'Shea

William P. O'Shea
Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure: Copy for § 6110 purposes
Copy of the letter